Vodafone input to Narrowband Markets Review:

The need for regulation of provision of Wholesale Lines

1. Introduction

Vodafone welcomes the opportunity to provide inputs to Ofcom's review of narrowband markets. This document provides a summary of why we consider it essential that regulation is continued for the wholesale provision of Wholesale Fixed Analogue Exchange Lines (WFAEL) and ISDN2 exchange lines, but not for ISDN30 exchange lines.

2. WFAEL

The arguments for continued regulation of WFAEL via Wholesale Line Rental (WLR) are basically the same as Vodafone set out in our response to Ofcom's Call For Inputs in June regarding the need for a call origination remedy, namely that there are significant market segments that rely upon the availability of the regulated service, that there are no effective market constraints on BT's pricing absent regulation, and that voluntary undertakings are insufficient.

2.1 Market Segments reliant upon regulated WLR

Vodafone considers that there are a series of market segments relying upon regulated WLR, which while diminishing in size represent a significant volume of customers. Further, a new segment since the last market review – superfast broadband customers – relies upon the availability of WLR and is exhibiting rapid growth.

2.1.1 Voice-only and non-bundled service lines

Ofcom's last Wholesale Access Review in 2013[1] suggested 13% of households took voice-only, i.e. without broadband. Although this figure is likely diminishing, this suggests that a significant volume of customers – and likely the more vulnerable in society at that – take a retail service which it is uneconomic to provide via any access capability other than WLR.

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[1] http://stakeholders.ofcom.org.uk/binaries/consultations/fixed-access-market-reviews/summary/fixed-access-markets.pdf , para 3.130

Similarly, the same review suggested that 18% of customers did not purchase their broadband and voice services in a bundled manner. These customers can only be readily served using WLR. Once again, this segment is likely to be diminishing as bundled services become more prevalent, but it would be a curious regulatory decision that essentially dictated that it was mandatory to sell bundled services at a retail level. If this were to be the case, it would call into question whether the market reviews for WFAEL, associated call service and broadband access were actually separable.

2.1.2 Bundled broadband customers in Non-LLU footprint area

Although the volume of exchanges outside the Local Loop Unbundling (LLU) footprint of competitive providers is diminishing, there still remains a significant tail of areas where WLR plus a wholesale broadband proposition is the only way that communication providers can compete with BT.

2.1.3 Superfast broadband customers

Superfast broadband represents the largest growth sector for fixed line communications. Absent their own infrastructure to the end-customer, competing providers have three principal means to offer a combined superfast broadband and voice proposition:

1. Provide broadband using a wholesale proposition from BT/Openreach, and provide voice using LLU and MSAN equipment at the local BT exchange.
2. Provide broadband using a wholesale proposition from BT/Openreach, and provide voice using regulated WLR.
3. Provide broadband using a wholesale proposition from BT/Openreach, and provide voice using an over-the-top VoIP approach.

Approach (1) has been adopted by Sky and TalkTalk, but is only commercially viable because their MSAN equipment at the local exchange is a sunk asset. In essence, for this customer the LLU pair back to the exchange, and MSAN equipment at the exchange, is being used for the provision of voice service only, and it has been demonstrated countless times that voice service alone is incapable of recovering the costs of MSAN provision. While Vodafone fully understands why Sky and TalkTalk have taken this decision – to sweat their sunk assets and to ease migration between conventional and superfast broadband services – it would be wrong if regulation were to preclude market entrance by relying upon the existence of sunk assets.

Approach (3) may well form the long term technology approach for bundled superfast services. However, it is dependent upon a "naked VULA" service that would allow providers to run their services in this manner without having to purchase a copper access product and be priced in a manner reflecting the assets used in the access network. Openreach is taking baby-steps in providing such a capability, but at present it cannot be considered fit-for-purpose because the pricing is analogous to a situation where WLR had been purchased, leaving no margin for competing providers to implement the necessary voice network. As Vodafone explained in its earlier submission, this is largely because the assumed cost stack includes provision of copper pairs back to the exchange, even though they are not needed for the customer any more. Further, the necessary home wiring products are at best nascent.

Therefore, at present approach (2) is the only viable approach for a new entrant wishing to provide a bundled superfast broadband and voice service. Were regulation of WLR to fall away, it therefore follows that, unless and until approach (3) was industrialised at suitable pricing, Ofcom would be precluding market entrance to the largest growth market.

2.2 Lack of market constraints

Absent regulation of WFAEL, the only prospective retail market constraints that would either compel BT to offer WLR at a reasonable rate, or render it unnecessary, are voice provided over IP (VoIP) and mobile. Vodafone considers that neither provides an effective competitive constraint.

2.2.1 VoIP

It is now increasingly possible to support voice over the internet rather than relying upon analogue lines.

However, for one segment described in the previous section – voice-only customers – this is clearly not a practicable proposition because they will not have a broadband service.

Even for the remaining segments described above where customers will have broadband of some description, however, Vodafone questions how existence of a retail VoIP proposition will constrain the need for and pricing of WFAEL. There has to be a broadband service to host the VoIP proposition;

1. In order to supply the broadband service using a wholesaled BT broadband capability the competitive provider has to overlay it on some form of access product. In non-LLU areas, by definition this cannot be LLU; that only leaves WLR.

2. For superfast customers, in order to supply the broadband service, as outlined above new entrants are either reliant upon WLR, or upon a not-yet fit-for-purpose naked-VULA service.

Retail VoIP cannot provide a competitive constraint for the need for WFAEL, if the provision of VoIP is itself contingent upon the provision of WFAEL.

2.2.2 Mobile

Voice traffic carried on mobile networks now outstrips that on fixed networks. Arguably, then, a provider could target customers with a proposition that their voice is carried on mobile networks, and (if required) their broadband is carried over a fixed network.

For doubleplay customers, however, as we describe above, the provision of the broadband service would still be reliant upon WFAEL, so it is difficult to see how this would be done. Notwithstanding this, as we described in greater detail in our May response to the CFI, because the competing services would come with fixed line voice capability for broadly the same price, a "mobile voice only" service would be uncompetitive.

For voice-only customers, there is an argument that customers could use a mobile rather than fixed line. However, whilst mobile operators strive to provide great coverage (indeed have accepted a legal commitment to extend coverage), there is still a minority of households that cannot rely on uninterrupted mobile coverage. Evidence is required as to how lack of mobile coverage correlates with non-LLU areas which are more reliant on WLR; we suspect they may align. Finally, although mobile termination rates have fallen to a very low level, this has not been accompanied by a corresponding fall in retail tariffs to call mobiles – customers substituting mobile for fixed service will drive additional costs for their friends and family, unless they similarly move to mobile (where there is typically no differentiation in retail pricing between calls to fixed and mobile numbers). For these reasons, although we accept that mobile provides a weak constraining force on the availability/price of WFAEL, it is insufficient to act as a proxy for regulation.

2.2.3 LLU

If neither VoIP nor mobile retail services provide any constraint to WFAEL pricing, does MPF LLU provide a constraint? Is there an argument that if BT failed to provide WLR at a suitable price, competing providers would instead purchase MPF LLU and deploy their own MSAN equipment there to provide voice service?

Whilst there is some logic to this, lack of regulation would be forcing competing providers to revert to deploying legacy technology – in a superfast broadband environment the exchange is increasingly a redundant node, as the future is conversion of voice to an application at the customer premises, and (at least in the FTTC architecture adopted by Openreach) broadband being streamed onto fibre at the street cabinet. We acknowledge that Sky and TalkTalk continue to operate exchange-based MSAN equipment, but this is legacy deployment rather than what an efficient new entrant would utilise. If a new entrant were forced to deploy such equipment, it is Vodafone's assertion that such new entrance would be uneconomic and an oligopoly would develop, LLU can therefore not be relied upon to be a competitive constraint on WLR pricing.

2.3 Voluntary undertakings are insufficient - BT's scale consumption of WLR requires regulatory transparency

An alternative to continued regulation could be that Openreach provided voluntary commitments to continue to provide WLR in an agreed pricing envelope. This is not acceptable to Vodafone. We cannot make a compelling business case to invest which is dependent upon our largest competitor making voluntary commitments – our investments must be based upon firm regulatory underpinnings.

By far the largest consumer of WLR 3 is BT's own downstream retail divisions, with BT's internal consumption three times greater than external purchasers. The existing accounting separation obligation enables the service to be purchased in a transparent way with WLR cost information published to ensure non-discrimination and charge control compliance. With retail services increasingly being purchased in bundles it is necessary to ensure that the costs of the constituent parts of the bundle are properly understood to deter anti-compeittive behaviour, especially where other wholsale services like MPF may be used to deliever bundled services to consumers. If BT continues to make use of an unregulated services to compete with other CPs, this greatly increases the risks of predatory pricing, especially where non identical inputs are used (for example unregulated WLR + SMPF competing with MPF based services).

In summary, there are significant, and overall growing, market segments that rely upon the provision of regulated WFAEL, there are no reasonable market constraints that might offer an alternative to regulation, and industry requires the stability of regulation rather than voluntary commitments in order to invest at scale.

3. Business WFAEL

At present, Ofcom does not regulate business grade derivatives of WFAEL, i.e. WLR Premium. Vodafone understands that Ofcoms rationale is "standard" WLR provides a competitive constraint on WLR Premium, in as much that if BT increased the price of Premium too much, coperators would migrate to standard WLR in preference. Given the focus on BT's QoS performance recently, Vodafone believes that Ofcom should examine this topic to see if the logic holds true.

4. ISDN2

ISDN2 remains a niche market, but not one that we are seeing go into terminal decline. Vodafone has provided Ofcom with information as to the usage of ISDN2 lines, that we provide solely via Openreach's WLR service. We are unable to provide information on what use our customers put the capability to, but suspect it is predominately retail "satellite" sites (i.e. shops) that form part of wider enterprise deployment.

We are unaware of any market failure that would necessitate intervention at a retail level.

At a wholesale level, there is clearly ongoing demand, and absent a wholesale capability there is a risk that the wider enterprise market would be compromised. A multi-site corporate faced with the scenario of BT being able to provide an holistic service, and other communications providers only being able to provide service where it was practicable to serve them via LLU or Ethernet services, would inevitably look more favourable on BT's proposition. Vodafone therefore considers that ongoing regulation is appropriate.

5. ISDN30

Rumours of the death of ISDN are overstated. Vodafone has provided Ofcom with information as to the usage of ISDN30 lines, [✂]. Over coming years, these will be migrated to an IP infrastructure with gateways continuing to provide the ISDN connectivity. We see little need for regulatory intervention in this market, with a regulated ISDN 2 wholesale service acting as a pricing constraint while demand remains